



**JOHN CHIANG**  
**California State Controller**

September 30, 2011

K-12 Local Education Agencies (School Districts, County Offices of Education, and Charter Schools), Joint Powers Entities, and Certified Public Accountants  
Performing Audits of California K-12 Local Education Agencies

Re: Annual Audits for Fiscal Year 2010-11

This advisory provides information to assist independent auditors in performing the fiscal year 2010-11 audits of Local Education Agencies (LEAs) and joint powers entities.

**K-12 LEA WEB PAGE**

This audit advisory, as well as general guidelines for audits of K-12 LEAs, is available on the California State Controller's Office (SCO) K-12 LEA website,  
[http://www.sco.ca.gov/aud\\_k12\\_lea.html](http://www.sco.ca.gov/aud_k12_lea.html).

**PROCEDURAL**

1. The requirements specified in Education Code section 41020 are applicable to all LEAs, including joint powers entities and charter schools. As a result, audits shall be conducted in accordance with auditing standards generally accepted in the United States of America, the standards set forth in *Government Auditing Standards* issued by the Comptroller General of the United States, and the provisions of *California Code of Regulations* (CCR), Title 5, Education, Section 19810, et seq.
2. The report shall be presented as prescribed in the *Standards and Procedures for Audits of California K-12 Local Education Agencies 2010-11* (K-12 Audit Guide) and the *California Code of Regulations* (CCR), Title 5, Education, Section 19810, et seq. For additional guidance, refer to the American Institute of Certified Public Accountants (AICPA) *Audit and Accounting Guide for State and Local Governments* and the AICPA *Government Auditing Standards and Circular A-133 Audits* with conforming changes as of March 1, 2011, and April 1, 2011, respectively.
3. Charter schools that are included in the sponsoring entity's financial statement audit are not required to submit a separate report to the SCO, the California Department of Education (CDE), or the local County Office of Education.

4. For audits in which charter schools are included in the district's financial statement audit, the auditor is expected to stratify the sample so that a representative number of charter schools (classroom and non-classroom based) are tested annually for state compliance and federal compliance, if applicable. In cases where a district has only one charter school, the auditor must apply state compliance audit procedures annually.
5. The State's report certification process requires that the SCO perform a desk review of the LEA's annual audit report. The review will ensure that the audit report meets the minimum reporting standards contained in the audit guide. The SCO will then reject or certify the report.

If the SCO rejects the report, a letter is sent to the independent auditor and LEA that describes the exception(s) noted during the SCO's review. The auditor has 30 days from receipt of the letter to make the correction. Upon receipt of the revised audit report, the SCO will review the correction and notify the auditor and LEA of the review results. The audit fee percentage stipulated in the audit contract must be withheld until the audit report is certified.

If the SCO certifies the report, the LEA and auditor will receive a letter stating that the audit report conforms to the reporting standards contained in the audit guide. The letter also specifies that the LEA may release the portion of the audit fee withheld under the provisions of California Education Code section 14505.

If the audit report contains a finding or findings that may be considered apportionment significant, the SCO will send the LEA a certification letter with information on its appeal rights. The LEA has 30 days from the date on which the U.S. Postal Service delivers the letter to request summary review of any apportionment-significant audit finding or findings, on the grounds of substantial compliance. In addition, the LEA has 60 days from delivery of the letter or 30 days following the conclusion of a summary review, with regard to the findings included in that review, to file a formal appeal of any apportionment significant finding or findings on any one or more of the grounds set forth in California Education Code section 41344(d). For more information on audit finding appeals, visit the Education Audit Appeals Panel website at <http://eaap.ca.gov/NewWebSite0804/EAAPAppeals.htm>.

6. Fiscal year 2010-11 audit reports must be filed with the SCO, CDE, local County Superintendent of Schools, and, if applicable, the chartering entity, by December 15, 2011. Independent auditors must submit to the SCO one copy of the report either by U.S. Postal Service, private carrier, or via File Transfer Protocol (FTP). If you wish to use the FTP option and do not have instructions for doing so, please contact the SCO to request the FTP instructions at [leaaudits@sco.ca.gov](mailto:leaaudits@sco.ca.gov) or leave a voicemail message at (916) 324-6442. Due to security protocol, the SCO cannot provide FTP instruction packets containing username and password by email or by phone. When requesting an instruction packet, please include the following: firm name, Attention: to, mailing address, and phone number.

Mailing Address

State Controller's Office  
Division of Audits  
School District Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874

Private Carrier Delivery

State Controller's Office  
Division of Audits  
School District Audits  
3301 "C" Street, Suite 700  
Sacramento, CA 95816

7. For information on filing extensions, see the Report Certification Compliance Reminders section of this advisory.
8. Certified public accountants or public accountants who wish to conduct LEA audits must be added to the Certified Public Accountants Directory published by the SCO. To be included in the directory, a written request must be submitted to the SCO prior to conducting the audits. Instructions for submitting the request can be found at the SCO's website at <http://www.sco.ca.gov/cpads/>.
9. The auditor-rotation requirements specified in California Education Code section 41020 (f)(2) apply to auditors who conduct LEA audits. This section of the Education Code makes it unlawful for a public accounting firm to provide audit services to the LEA if the lead audit partner, or coordinating audit partner responsible for the audit or for reviewing the audit, has performed audit services for the LEA in each of the six previous fiscal years. Consequently, a different audit firm and/or audit partners must be used in the seventh year, unless a waiver is obtained from the Education Audit Appeals Panel.
10. To obtain a copy of the Desk Review Checklist for K-12 LEAs or check the status of an LEA audit report, visit the SCO's website at [http://www.sco.ca.gov/aud\\_k12\\_lea.html](http://www.sco.ca.gov/aud_k12_lea.html); send a request to [leaaudits@sco.ca.gov](mailto:leaaudits@sco.ca.gov); or leave a voicemail message at (916) 324-6442. The FY 2010-11 Desk Review Checklist will be posted by mid-November.

**K-12 AUDIT GUIDE**

The audit guide is published by the Education Audit Appeals Panel (EAAP) pursuant to rulemaking procedures. The title of the audit guide for fiscal year 2010-11 is *Standards and Procedures for Audits of California K-12 Local Education Agencies 2010-11*. The audit guide is prescribed in 5 CCR, section 19810, et seq. It is available through the EAAP's website at [www.eaap.ca.gov](http://www.eaap.ca.gov).

**AMERICAN RECOVERY AND REINVESTMENT ACT (ARRA)**

ARRA imposes transparency and accountability requirements on federal awarding agencies and their recipients.

1. **Schedule of Expenditures of Federal Awards (SEFA)** - Expenditures for federal awards under ARRA must be separately identified in the schedule as a separate row by Catalog of Federal Domestic Assistance (CFDA) number, and inclusion of the prefix "ARRA" must be

included in identifying the name of the federal program. If ARRA funding is received by a subrecipient, the name of the pass-through entity and the identifying number assigned by the pass-through entity must be included.

## 2. Effect of Expenditures of ARRA Awards on Major Programs

- a. **Type A programs (SFA Excluded)** - Any program or cluster with expenditures of ARRA awards would not qualify as low-risk Type A. However, the auditor may consider a Type A program or cluster to be low-risk if **all** of the following conditions are met:
  - The program or cluster had ARRA expenditures in the prior period;
  - The program or cluster was audited as a major program in the prior audit period;
  - The ARRA expenditures in the current audit period are less than 20% of the total program or cluster expenditures; and
  - The auditor has followed section .520(c) and section .525 of OMB Circular A-133 and determined that the program or cluster is otherwise low-risk.
- b. **Type B Programs (SFA Excluded)** - The auditor should consider all Type B programs and clusters with expenditures of ARRA award to be programs of higher risk in accordance with section .525(d) of OMB Circular A-133.
- c. Audit findings involving ARRA federal award programs must be separately identified and presented in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart E – Auditors, section .510.

## **REPORT CERTIFICATION COMPLIANCE REMINDERS**

During the SCO's annual audit report certification process, a significant amount of time is spent corresponding with independent auditors regarding audit report deficiencies. To expedite certification of audit reports for fiscal year 2010-11, the SCO requests that auditors adhere to the following guidelines when completing their audit reports. Failure to comply with the subsequent requirements will result in audit reports being rejected.

1. **Early Retirement Incentive Note Disclosure:** The note must be presented in the Notes to the Basic Financial Statements as required in Section 19830.1 of the K-12 Audit Guide. Historically, the SCO has accepted audit reports that included this note disclosure in the Notes to the Supplementary Information section of the audit report; however, the Audit Guide requires this note disclosure to be included in the Notes to the Basic Financial Statements.

2. **Report on Federal Compliance:** The Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With Circular A-133 must be updated to reflect the requirements of SAS No. 117 (AU§801.30).

SAS 117 is effective for compliance audits for fiscal periods ending on or after June 30, 2010. The American Institute of Certified Public Accountants (AICPA) Audit Guide *Government Auditing Standards and Circular A-133 Audits* with conforming changes as of April 1, 2011, includes required report elements and examples of the federal compliance report. **Reminder:** the report must have a title that includes the word “independent.”

3. **Report on State Compliance:** The report must be updated to reflect the requirements of SAS No. 117 (AU§801.30).

SAS 117 requirements will be included in the 2011-12 K-12 Audit Guide. However, due to the timing of the release of SAS No. 117, these requirements are not reflected in the 2010-11 K-12 Audit Guide. AICPA Codification of Statement on Auditing Standards provides, in Section 801.22, that “In instances where audit guidance by a governmental agency for the performance of compliance audits has not been updated for, or otherwise conflicts with, current GAAS or Government Auditing Standards, the auditor should comply with the most current applicable GAAS or Government Auditing Standards instead of the outdated or conflicting guidance.”

Therefore, audit reports for fiscal year 2010-11 must be updated to reflect the requirements of SAS No. 117. The required elements for the Report on State Compliance are listed in AICPA Codification of Statements on Auditing Standards, AU§801.30, and are also included as an attachment to this advisory.

4. **Management Letter:** If the Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards* refers to a management letter, then a copy of the letter must be submitted along with the LEA’s annual report.

In addition, the management letter should not include attendance or state program compliance findings.

5. **Extensions for Submitting Audit Reports:** The County Office of Education must submit its approved extension request to the SCO and the CDE by December 1, 2011. The extension request must come from the County Office of Education and not the LEA or CPA. The SCO will not consent to the extension request unless the circumstance leading to the request is extraordinary.

The SCO does not grant extensions for charter school audits. The extension must be obtained through the chartering entity, and the chartering entity should notify the SCO and the CDE of the extension.

If the LEA obtains an approved extension, the audit report should include an internal control finding or management letter comment. AU Section 325, Communicating Internal Control Related Matters Identified in an Audit, establishes standards and provides guidance on communicating matters related to an entity's internal control over financial reporting identified in an audit of financial statements.

If, in the CPA's professional judgment, this delay does not warrant an internal control finding or management letter comment, a separate written explanation should be provided to the SCO.

Audit reports submitted after the December 15 deadline without an approved extension should also include an internal control finding or management letter comment.

6. **Governmental Accounting Standard Board (GASB) Statement No. 54—Fund Balance Reporting and Governmental Fund Type Definitions:** GASB Statement 54 changes how the fund balance section of the governmental fund financial statements is presented. It also clarifies definitions of certain governmental fund types.

The CDE issued a letter dated January 7, 2011, entitled New Requirements for Reporting Fund Balance in Governmental Funds; the letter is available on the CDE website. This letter discusses key provisions of GASB Statement No. 54, identifies implementation issues for LEAs, and provides guidance on accounting for the new fund balance classifications in the standardized account code structure (SACS).

7. **Schedule of Average Daily Attendance (ADA):** If there are any ADA adjustments due to audit findings, the schedule must display additional columns for the Second Period and Annual Reports reflecting the final average daily attendance after audit finding adjustments, as required by Section 19816(i) of the K-12 audit guide. The schedule of ADA for charter schools, as well as LEAs that include a charter school or schools in their financial statements, must display total ADA and ADA generated through classroom-based instruction. For LEAs that include multiple charter schools, the classroom-based ADA for each charter school must be presented.
8. **Schedule of Instructional Time – Sponsoring Entity (school district or county office of education) with Charter (s):** For audits in which the charter school(s) is included in the sponsoring entities' audit report, a separate Schedule of Instructional Time for each charter school must be included in the supplementary information section of the audit report. This

schedule is required by Section 19854(d) of the K-12 audit guide. If the charter school's instructional minutes conform to those of the sponsoring entity, a footnote should be included on the schedule. However, note that the reduced minutes specification for charters is different from that of the sponsoring entity.

9. **Elements of Audit Findings:** Each audit finding should be presented in the following level of detail:

- State or federal program information
- Finding code (e.g., 10000 Attendance, 20000 Inventory of Equipment)
- Criteria or specific requirement
- Condition
- Effect
- Cause
- Questioned costs
- Recommendation
- LEA's corrective action plan

10. **State Compliance Findings:** The financial impact of state compliance findings must be quantified. The audit guide includes specific information that must be included in each finding. This information must be presented in order for the SCO to accept the finding. For example, for attendance findings, the audit guide requires that the audit report include a statement of the number of units of ADA that were inappropriately reported for apportionment, an estimate of their dollar value, and a statement consistent with its basis of funding for any other inappropriately reported claim. If there is no financial impact, the finding must describe the reasons for the auditor's conclusion.

The stated criteria should refer to a California state law or regulation that governs the program. The SCO will not accept reports that cite *Standards and Procedures for Audits of California K-12 Local Educational Agencies* as the criteria.

11. **Basic Aid School Districts:** When quantifying the questioned costs of attendance audit findings for basic aid school districts, please remember that changes in ADA may affect special education funding for the district's SELPA. You may contact CDE's Principal Apportionment Unit at (916) 324-4541 or [hle@cde.ca.gov](mailto:hle@cde.ca.gov) with any questions.

12. **Federal Compliance Findings:** For single audits with federal compliance findings, the SCO will not accept reports with federal findings that are not presented in accordance with the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, subpart E–Auditors, section .510.

If a finding includes multiple programs, including ARRA programs, the finding should identify each program by Catalog of Federal Domestic Assistance (CFDA) number and name (including ARRA identification, if applicable), and provide questioned costs for each program.

If you have any questions or need additional information, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, Division of Audits, at (916) 322-4846 or [cmoorehudnall@sco.ca.gov](mailto:cmoorehudnall@sco.ca.gov).

Sincerely,

*Original signed by*

JEFFREY V. BROWNFIELD  
Chief, Division of Audits  
State Controller's Office

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Attachment

cc: Tom Torlakson, Superintendent  
California Department of Education



***Required Elements -- Report on Compliance Only<sup>1</sup>***

The auditor's report on compliance should include the following elements:

- a. A title that includes the word *independent*
- b. Identification of the one or more government programs covered by the compliance audit or reference to a separate schedule containing that information
- c. Identification of the applicable compliance requirements or a reference to where they can be found
- d. Identification of the period covered by the report
- e. A statement that compliance with the applicable compliance requirements is the responsibility of the entity's management
- f. A statement that the auditor's responsibility is to express an opinion on the entity's compliance with the applicable compliance requirements based on the compliance audit
- g. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and the governmental audit requirement
- h. A statement that the compliance audit included examining, on a test basis, evidence about the entity's compliance with those requirements and performing such other procedures as the auditor considered necessary in the circumstances
- i. A statement that the auditor believes the compliance audit provides a reasonable basis for his or her opinion
- j. A statement that the compliance audit does not provide a legal determination of the entity's compliance
- k. The auditor's opinion, at the level specified by the governmental audit requirement, on whether the entity complied, in all material respects, with the applicable compliance requirements

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<sup>1</sup> AICPA *Codification of Statements on Auditing Standards*, AU §801.30

- l. If noncompliance that results in an opinion modification is identified, a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule (Ref: par. .A34)
- m. If other noncompliance that is required to be reported by the governmental audit requirement is identified (that is, noncompliance that does not result in an opinion modification), a description of such noncompliance or a reference to a description of such noncompliance in an accompanying schedule (Ref: par. .A34)
- n. If the criteria used to evaluate compliance are
  - i. established or determined by contractual agreement or regulatory provisions that are developed solely for the parties to the agreement or regulatory agency responsible for the provisions or
  - ii. available only to the specified parties,a separate paragraph at the end of the report that includes (1) a statement indicating that the report is intended solely for the information and use of the specified parties (2) an identification of the specified parties to whom use is restricted, and (3) a statement that the report is not intended to be and should not be used by anyone other than the specified parties (Ref: par. .A33)
- o. The manual or printed signature of the auditor's firm
- p. The date of the auditor's report